## MERGERS AND ACQUISITIONS FRAMEWORK

Merger: A merger is an agreement that unites two existing companies into one new company. Mergers are commonly done to expand a company's reach, expand into new segments, or gain market share. All of these are done to increase shareholder value. Often, during a merger, companies have a no-shop clause to prevent purchases or mergers by additional companies.

Acquisition: An acquisition is referred to as a business transaction in which one firm buys all or part of another company's stock or assets. The acquisition commonly happens to gain control of and expand on the target company's strengths while also capturing energies.

## TYPES OF M&A CASES

There are two types of M&A cases you'll see in consulting case interviews:

### Type 1: A company acquiring or merging with another company

The first type of M&A case is the most common. A company is deciding whether to acquire or merge with another company.

Example: Walmart is a large retail corporation that operates a chain of supermarkets, department stores, and grocery stores. They are considering acquiring a company that provides an online platform for small businesses to sell their products. Should they make this acquisition?

There are many reasons why a company would want to acquire or merge with another company. In making an acquisition or merger, a company may be trying to:

- Gain access to the other company's customers
- Gain access to the other company's distribution channels
- Acquire intellectual property, proprietary technology, or other assets
- Realize cost synergies
- Acquire talent
- Remove a competitor from the market
- Diversify sources of revenue

### Type 2: A private equity firm acquiring a company

The second type of M&A case is a private equity firm deciding whether to acquire a company. This type of M&A case is slightly different from the first type because private equity firms don't operate like traditional businesses.

Private equity firms are investment management companies that use investor money to acquire companies in the hopes of generating a high return on investment. After merging or acquiring a company, a private equity firm will try to improve the company's operations and drive growth. After a number of years, the firm will look to sell the acquired company for a higher price than what it was originally purchased for.

Example: A private equity firm is considering acquiring a national chain of tattoo parlors. Should they make this investment?

There are a few different reasons why a private equity firm would acquire a company. By investing in a company, the private equity firm may be trying to:

- Generate a high return on investment
- Diversify its portfolio of companies to reduce risk
- Realize synergies with other companies that the firm owns

## STEPS INVOLVING IN SOLVING A MERGERS & ACQUISITIONS CASE

### 1. Reiterate the problem statement

Once the problem statement is told, reiterate the problem in a comprehensive manner as to know if the understanding of the problem by you is appropriate. If there would be any discrepancy, the interviewer would let you know then and there itself.

### 2. Ask preliminary questions

Start with some questions in order to know more about the company and its objective.
Some clarifying questions that can be asked are as follows:

- What does the client do? What are the current geographies they operate in?
- What will happen to the current leadership team?
- What is the product roadmap for the next six months to a year?
- Will there be a rebrand?
- Are there future acquisitions or mergers planned in the next year or two?

The most important preliminary question for any M&A case is to understand the reason/objective for the merger or acquisition. Knowing the reason for the merger or acquisition is necessary to have the context to properly assess whether the merger or acquisition should be made.

The three most common reasons are:

- The company wants to generate a high return on investment
- The company wants to acquire intellectual property, proprietary technology, or other assets
- The company wants to realize revenue or cost synergies

Once you understand what's driving the M&A desire, you'll know what lens to apply throughout the remainder of the case. You'll also be able to weave in your business acumen in your final recommendation.

### 3. Quantify the specific goal or target

When you understand the reason for the merger or acquisition, identify what the specific goal or target is. Try to use numbers to quantify the metric for success.

For example, if the company wants a high return on investment, what ROI are they targeting? If the company wants to realize revenue synergies, how much of a revenue increase are they expecting?

Depending on the case, some goals or targets may not be quantifiable. For example, if the company is looking to diversify its revenue sources, this is not easily quantifiable.

### 4. Create a M&A framework and work through the case

With the specific goal or target in mind, structure a framework to help guide you through the case. Your framework should include all of the important areas or questions you need to explore in order to determine whether the company should make the acquisition.

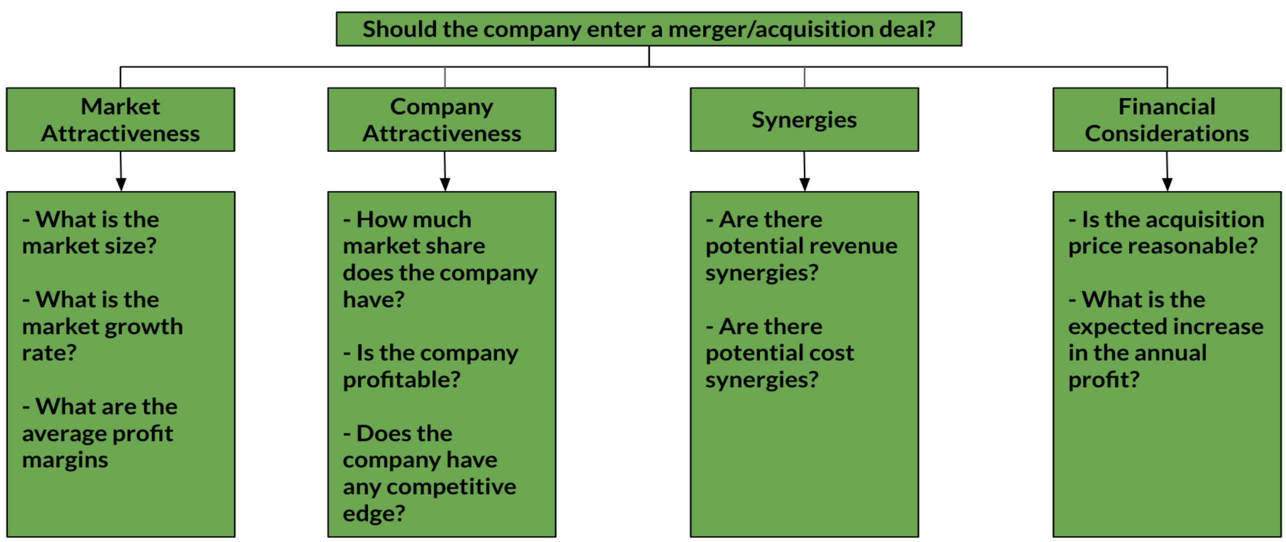
The perfect M&A case framework breaks down the complex question of whether or not the company should make the Mergers and acquisitions into smaller and more manageable questions.

For Mergers and acquisitions cases, there are four major areas that are the most important.

- Market attractiveness: It is the degree to which a market offers opportunities to an organization, taking into account the market size and growth rate and the level of competition and other constraints.

- Company attractiveness: Being attractive as a company means having a high level of appeal to potential future employees and being able to retain existing colleagues in the long term.
- Synergies: Synergy is the concept that the combined value and performance of two companies will be greater than the sum of the separate individual parts.
- Financial considerations: Anything of value that is promised by one party to another can be viewed as a consideration.

To assess this, you can look at the following questions:




## 5. While considering a M&A take into consideration risks OR consider alternative Mergers and acquisitions targets along with the risks

Your M&A case framework will help you investigate the right things to develop a hypothesis for whether or not the company should make the merger or acquisition.

The next step in completing an M&A case depends on whether you are leaning towards recommending making the Mergers and acquisitions or recommending not making the mergers and acquisitions.

If you are leaning towards recommending making the acquisition:

- Explore the potential risks of the merger and acquisitions.
- How will the Mergers and acquisitions affect existing customers? Will it be difficult to integrate the two companies? How will competitors react to this acquisition?
- If there are significant risks, this may change the recommendation that you have.

If you are leaning towards NOT recommending making the acquisition:

- Consider other potential Mergers and acquisitions targets along with the risks.
- Remember that there is always an opportunity cost when a company makes a merger or acquisition. The money spent on making the Mergers and acquisitions could be spent on something else.
- Is there another Mergers and acquisitions target that the company should pursue instead? Are there other projects or investments that are better to pursue? These ideas can be included as next steps in your recommendation.

## 6. Deliver a recommendation and propose next steps

At this point, you will have explored all of the important areas and answered all of the major questions needed to solve the case. Now it is time to put together all of the work that you have done into a recommendation.

Structure your recommendation in the following way so that it is clear and concise:

- State your overall recommendation firmly
- Provide three reasons that support your recommendation
- Propose potential next steps to explore

## FORMULA LIST

These formulae can be useful while evaluating whether a company should go ahead with a merger/acquisition.

1. **Cash Flows**

**Free Cash Flow =** Net income + Depreciation/Amortization – Change in Working Capital – Capital Expenditure

**Operating Cash Flow =** Operating Income + Depreciation – Taxes + Change in Working Capital

**Cash Flow Forecast =** Beginning Cash + Projected Inflows – Projected Outflows = Ending Cash

2. **Net Present Value**

**NPV =** F / [ (1 + i)^n ]

Where,

PV = Present Value
F = Future payment (cash flow)
i = Discount rate (or interest rate)
n = the number of periods in the future the cash flow

3. **Market**

**Market Size =** Core Target Market x Potential Penetration in the Target Market
**Market Share =** (Total Sales of the Company/Total Sales of the Market) x 100
**Market Growth % =** (Projected Market Size - Original Market Size at the beginning of the defined time period) / Original Market Size x 100

4. **Profitability**

**Projected Profit =** Market size x Market Share x {(Price-Cost)/Unit} - Fixed costs

5. **Rate of Investment (ROI)**

**ROI =** Net income/Cost of Investment x 100